



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
DONALD S. AND MAXINE CHUCK)

For Appellants: Fernando A. Jimenez
Certified Public Accountant

For Respondent: Jon Jensen
Counsel

O P I N I O N

These appeals are made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Donald S. and Maxine Chuck against proposed assessments of additional personal income tax in the amounts of \$554.64 and **\$2,340.42** for the years 1976 and 1977, respectively.

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During the years in issue, appellants were employed by El Camino Crop Supply, Inc. (hereinafter referred to as "El Camino"). El Camino is apparently engaged in the distribution and application of fertilizer. In 1976, appellants received from El Camino salaries aggregating, \$63,600; their combined salaries totaled \$73,600 in 1977. In addition to their employment by El Camino, appellants also owned and operated the Double C Ranch in Oakdale, California. Double C's operations resulted in reported losses of \$47,329 in 1976 and \$80,553 in 1977. Those losses were reported as net farm losses by appellants on their joint California personal income tax returns. In computing their taxable income for each of the appeals years, appellants deducted their net farm losses from their salaries and other income. Appellants did not, however, report any portion of their net farm losses as items of tax preference income.

Upon examination of appellants' returns, respondent determined that the salaries they received from El Camino did not constitute income from the trade or business of farming for purposes of computing their "net farm loss" tax preference income. Respondent concluded that the amounts of net farm loss in excess of \$15,000 (\$32,329 in 1976 and \$65,553 in 1977) were reportable as items of tax preference income and issued the subject proposed assessments based on the resultant increase in appellants' tax liability. Appellants protested respondent's action, asserting that the salary income received from El Camino constituted income from the trade or business of farming, which completely offset the farm losses incurred by the Double C Ranch. Appellants' argument apparently was, and remains, based upon the theory that their salaries were derived from a corporation engaged in the business of farming. After consideration of appellants' position, respondent affirmed the subject proposed assessments, thereby resulting in these appeals.

The sole issue presented for our determination is whether the salary income received by appellants from El Camino constituted income from the trade or business of farming for purposes of computing the amount of appellants' "net farm loss" tax preference income.

Revenue and Taxation Code section 17063,^{1/} subdivision (i), as it existed for the years in

^{1/} Hereinafter, all references are to the Revenue and Taxation Code, unless otherwise indicated.

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issue,^{2/} included as an item of tax preference income "[t]he amount of net farm loss in excess of fifteen thousand dollars (\$15,000) which is deducted from **nonfarm** income." The term "**farm net** loss" is defined by section 17064.7 as:

. . . the amount by which the deductions allowed by this part which are directly connected with the carrying on of the trade or business of farming, exceed the gross income derived from such trade or business. (Emphasis added.)

Appellants argue that the income-in issue is income from the trade or business of farming because it was earned by them as employees of a corporation involved in that business. After a careful review of the record on appeal, and for the specific reasons set forth below, however, we conclude that respondent properly determined that the salary income received by appellants as employees of El Camino did not **constitute** income from the trade or business of farming for purposes of determining their "net farm loss" tax preference income.

Former section 17063, subdivision (i), was intended to replace former section 18220. While it changed the method of determining tax motivated farm loss operations, the focus of the new section, i.e., "farm net loss", remained the same as that of the section it replaced. Except for certain provisions not in issue here, section 17064.7 defines "farm net loss" in a manner identical to that of former section 18220, subdivision ^{3/}(e). Pursuant to respondent's regulation 19253,^{3/} the regulations adopted pursuant to

^{2/} AB 93 (Stats. 1979, Ch. 1168), operative for taxable years beginning on or after January 1, 1979, rewrote subdivision (i) of section 17063 as subdivision (h) and increased the excluded amounts thereunder.

^{3/} In pertinent part, this regulation provides as follows:

In the absence of regulations of the Franchise Tax Board and unless otherwise specifically provided, in cases where the Personal Income Tax Law conforms to the Internal Revenue Code, regulations under the Internal Revenue Code shall, insofar as possible, govern the interpretation of conforming state statutes . . .

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Internal Revenue Code section 1251 (after which former section 18220 was patterned) governed the interpretation of the term "farm net loss" under former section 18220, subdivision (e). Given the successor relationship between section 17064.7 and former section 18220, subdivision (e), the Treasury regulations enacted pursuant to section 1251 of the Internal Revenue Code are applicable for purposes of interpreting the term "farm net loss" as it appears in section 17064.7.

Treasury Regulation § 1.1251-3(b) defines "farm net loss" as follows:

(b) . . . The term "farm net loss" means the amount by which--

(i) The deductions allowed or allowable for the taxable year by chapter 1 of subtitle A of the Code which are directly connected with the carrying on of the trade or business of farming, exceed

(ii) The gross income derived from such trade or business. (Emphasis added.)

Treasury Regulation § 1.1251-3(e)(1) defines the term "trade or business of farming" as follows:

. . . For purposes of section 1251, the term "**trade or business of farming**" includes any trade or business with respect to which the taxpayer may compute gross income under § 1.61-4, expenses under § 1.162-12, make an election under section 175, 180, or 182, or use an inventory method **referred** to in § 1.471-6. Such term does not include any activity not engaged in for profit within the meaning of section 183 and § 1.183-2.

According to the above, any taxpayer that may compute gross income under Treasury Regulation § 1.61-4 is engaged in the trade or business of farming. Treasury Regulation § 1.61-4 is identical to respondent's former regulation 17071(d). The latter, operative for the years in issue, designated as "farmers," "[a]ll individuals, partnerships, or corporations that cultivate, operate, or manage farms for gain or profit, either as owners or tenants" Similarly, respondent's regulation 17224(c) **provides** that "[a] taxpayer is engaged in the business of farming if he cultivates,

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operates, or manages a farm for gain or profit, either as owner or tenant." Under neither regulation is an employee of a corporation engaged in the business of farming defined as either a "farmer" or as a "taxpayer engaged in the business of farming." Finally, federal Revenue Rulings interpreting Treasury Regulation § 1.175-3 (the substantive federal equivalent to respondent's regulation 17224(c)) have determined that wages paid farm employees and fees paid to providers of customary farm services are to be excluded from the definition of gross income from farming. (See Rev. Rul. 65-280, 1965-2 Cum. Bull. 433; Rev. Rul. 77-105, 1977-1 Cum. Bull. 374.)

For the reasons set forth above, we conclude that appellants' contention that the salary income received from El Camino constituted income from the trade or business of farming for purposes of computing their "net farm loss" tax preference income is untenable. Accordingly, respondent's **action** in this matter will be sustained.

ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Donald S. and **Maxine Chuck** against proposed assessments of additional personal income tax in the amounts of \$554.64 and **\$2,340.42** for the years 1976 and 1977, **be and** the same is hereby sustained.

Ernest J. Dronenburg, Jr. , Chairman

Richard Nevins, Member

_____, Member